

23-Oct-2019

Hilton Worldwide Holdings, Inc. (HLT)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Hilton Third Quarter 2019 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Jill Slattery, Vice President Investor Relations. Please go ahead.

Jill Slattery

Vice President & Head of Investor Relations, Hilton Worldwide Holdings, Inc.

Thank you, Chad. Welcome to Hilton's third quarter 2019 earnings call. Before we begin, we would like to remind you that our discussions this morning will include forward-looking statements.

Actual results could differ materially from those indicated in the forward-looking statements. And forward-looking statements made today speak only to our expectations as of today. We undertake no obligation to publicly update or revise these statements.

For a discussion of some of the factors that could cause actual results to differ, please see the Risk Factors section of our most-recently filed Form 10-K. In addition, we will refer to certain non-GAAP financial measures on this call. You can find reconciliations of non-GAAP to GAAP financial measures discussed in today's call in our earnings press release and on our website at ir.hilton.com.

This morning, Chris Nassetta, our President and Chief Executive Officer, will provide an overview of the current operating environment and the company's outlook. Kevin Jacobs, our Executive Vice President and Chief Financial Officer, will then review our third quarter results and provide an update on our expectations for the year. Following their remarks, we'll be happy to take your questions.

With that, I'm pleased to turn the call over to Chris.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Thank you, Jill. Good morning, everyone, and thanks for joining us today. Our third quarter results continue to prove the strength of our business model as strong net unit growth drove solid bottom line performance. Adjusted EBITDA was towards the higher end of our guidance range, while adjusted EPS exceeded our expectations all in spite of softer-than-expected industry RevPAR performance.

Additionally, our strong portfolio of brands supported by our powerful commercial engines continued to drive strong market share gains. Year-to-date, we've increased our system-wide RevPAR index premium nearly 200 basis points, growing across all brands and all regions. Our performance continues to drive meaningful free cash flow generation. Year-to-date, we have returned approximately \$1.2 billion to shareholders in the form of buybacks and dividends, and we're on track to return \$1.6 billion to \$1.8 billion, or nearly 8% of our market cap for the full year.

In the quarter, we grew system-wide RevPAR 40 basis points, which was below our expectations due to softness in U.S. transient and Asia Pacific. System-wide group RevPAR increased more than 3% in the quarter boosted by

strength in company meetings. However, transient RevPAR was relatively flat across business and leisure falling short of expectations, due to weakening macro trends.

For the fourth quarter, we expect conditions to remain consistent with these trends. As a result, we now expect full year RevPAR of around 1%. As we look to next year, uncertainties in the macro environment make it difficult to forecast. Most indicators suggest continued economic growth for all major global regions, but at a slower pace. As a result, at this point we would expect full year 2020 RevPAR growth to be around flat to 1%. That said, we expect to continue to deliver net unit growth in the 6% to 7% range, which should continue to support solid bottom line performance next year. We will give you more specific guidance on our next call. Our robust development story remains a key driver of our continued success in delivering value beyond the broader fundamentals. Year-to-date, we've opened nearly 330 hotels totaling roughly 47,000 rooms and remain on track to deliver approximately 6.5% net unit growth for the full year. This will mark our fifth consecutive year of net unit growth above 6%.

At the end of the third quarter, our pipeline totaled nearly 379,000 rooms with continued growth across both U.S. and international regions. Developer appetite for our brands remain strong and we expect to deliver another year of record signings of over 115,000 rooms and record construction starts of more than 87,000 rooms, which supports our net unit growth outlook for the next several years. In the U.S., both signings and starts are tracking modestly ahead of our prior expectations with starts now forecast to grow nearly 20% in the U.S. for the full year.

Turning to openings. We welcomed our 100th Tru and our 2,500th Hampton, demonstrating continued growth in both new and existing brands. Since launching less than four years ago, Tru has established itself as the premier mid-scale brand with a RevPAR index of 130, the highest brand premium in the industry. At the other end of the spectrum, Hampton is one of our oldest brands, but remains a dominant player in its segment. After 35 years, Hampton still boasts an industry-leading RevPAR index of nearly 120 and a pipeline of more than 700 hotels.

Earlier this year, we announced that we are on track to open more luxury properties in 2019 than any year in our history. In the third quarter, these additions included the Waldorf Astoria Los Cabos Pedregal in Mexico, the Conrad Shenyang and the Conrad Tianjin in China, the Biltmore Mayfair, our first LXR property in Europe and the grand reopening of the Conrad New York Midtown following an extensive renovation and conversion from The London.

Overall, we think our disciplined and diversified development strategy positions us to capitalize on demand trends around the world throughout all parts of the cycle, while maximizing our net fees and driving significant shareholder returns. With over half of our pipeline under construction, we feel good about our ability to continue delivering over 6% net unit growth for the next few years. Our goal to deliver a brand for every traveler for any travel need they may have, anywhere in the world is resonating with our most loyal guests.

In the quarter, Hilton Honors members accounted for more than 62% of occupancy, increasing 430 basis points year-over-year. Additionally, unique Honors features like Connected Room and Digital Key along with our new "Expect Better. Expect Hilton." marketing campaign starring Anna Kendrick continue to attract new members. Honors enrollments increased 25% year-over-year in the quarter to total nearly 99 million members, and remain on track to hit our 100 million member milestone this week.

Our commitment to providing exceptional guest experiences and customer service would not be possible without our nearly 420,000 team members and the strong culture we have built together. I'm extremely proud that Hilton has maintained our number two ranking as a world's best place – best workplace and was also named the number one Best Workplace for Women in the U.S. With the support and dedication of our team members, we are able to grow our global footprint and have a positive impact on the communities where we live and work.

To sum it up with another quarter of solid bottom line performance, we remain confident in our fee-based business model and diversified capital-light growth strategy. This combined with our disciplined approach to capital allocation we think puts us in a great position to continue driving value for our guests, our owners and our shareholders.

With that, I'm going to turn the call over to Kevin for more details on the results and our outlook for the future.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

Thanks, Chris, and good morning, everyone. In the quarter, system-wide RevPAR grew 0.4% versus the prior year on a currency-neutral basis, as weaker transient demand in the U.S. and slower than expected Chinese leisure travel weighed on results. Despite softer macro trends, we continued to gain market share.

Adjusted EBITDA of \$605 million increased 9% year-over-year. Outperformance to the midpoint of guidance was primarily driven by greater cost control. In the quarter, management franchise fees increased 6% to \$577 million with strong net unit growth and license fees offsetting softer top-line performance. Diluted earnings per share adjusted for special items grew 13% to \$1.05 exceeding the high end of our guidance.

Turning to our regional performance and outlook. Third quarter comparable U.S. RevPAR grew 0.4%, as solid market share gains and good group business were offset by soft transient trends. For full year 2019, we forecast U.S. RevPAR growth in line with our system-wide guidance based on modestly softer macro trends.

In the Americas outside the U.S., third quarter RevPAR declined modestly versus the prior year largely due to hurricane-related weakness across the Caribbean. For full year 2019, we expect RevPAR growth in the region to be in the low single-digits.

RevPAR in Europe grew 2.4% in the quarter driven by increased demand across London, which benefited from a good city-wide calendar and strong international inbound trends. Results were further boosted by solid convention and trade show business across Turkey and Spain.

We expect full year 2019 RevPAR growth in Europe to be in the low single-digits given favorable trends across Continental Europe, modestly offset by continued Brexit uncertainty. In the Middle East and Africa region, RevPAR was slightly negative in the quarter. Similar to trends we've seen throughout the year, supply growth in the UAE continued to pressure rate growth. For full year 2019, we expect RevPAR growth in the region to be down in the low single-digits.

In the Asia Pacific region, RevPAR fell 2.7% in the quarter, as trade tensions intensified and protests in Hong Kong further weighed on leisure travel. As a result, RevPAR in China fell 5.6% in the quarter. For full year 2019, we expect RevPAR growth for the region to be flat to slightly down, with RevPAR in China declining in the low single-digits, reflecting a continuation of current trends.

Moving to our guidance, for full year 2018 (sic) [2019], we expect RevPAR growth of around 1% and adjusted EBITDA of \$2.285 billion to \$2.305 billion, representing a year-over-year increase of roughly 9% at the midpoint. We forecast diluted EPS, adjusted for special items, of \$3.81 to \$3.86.

For the fourth quarter, we expect system-wide RevPAR growth to be roughly flat. We expect adjusted EBITDA of \$563 million to \$583 million, and diluted EPS adjusted for special items of \$0.91 to \$0.96. Please note that our guidance ranges do not incorporate future share repurchases.

Moving on to capital return, we paid a cash dividend of \$0.15 per share during the third quarter for a total of \$43 million in dividends in the quarter. Our board also authorized a quarterly cash dividend of \$0.15 per share in the fourth quarter. Year-to-date, we have returned \$1.2 billion to shareholders in the form of buybacks and dividends.

For 2019, we expect to return between \$1.6 billion and \$1.8 billion to shareholders in the form of buybacks and dividends. Further details on our third quarter results and our latest guidance ranges can be found in the earnings release we issued earlier this morning.

This completes our prepared remarks. We would now like to open the line for any questions you may have. We would like to speak with all of you this morning, so we ask that you limit yourself to one question.

Chad, can we please have our first question?

QUESTION AND ANSWER SECTION

Operator: Sure. [Operator Instructions] The first question comes from Harry Curtis with Instinet. Please go ahead.

Harry C. Curtis

Analyst, Nomura Instinet LLC

Good morning, everybody.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Good morning, Harry.

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Harry C. Curtis

Analyst, Nomura Instinet LLC

Yes. Good morning. A quick question on your pipeline, which, again, was up sequentially as well as year-over-year despite what looks to be relatively flat corporate travel budgets, but developers still have a strong appetite to invest even in this decelerating economy. What do you think the disconnect is? And maybe you can speak to maybe the uniqueness of the Hilton brands or – but at the end of the day, do you expect it to continue?

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah. I think it's a good question. And I think the short answer is we do expect it to continue at least for the time being. I think what's going on with the developers, I mean, every region of the world is a little bit different story. But I think broadly, most of the folks that we're working with, particularly in the U.S., this is their business. They are, if you look at it, largely a very diversified group of owner/operators. A large part of it, again, particularly in the U.S., is franchise-based. And they are, as we're, and everybody that's running a business, trying to grow – ultimately grow their business, both on the ownership and on the operating side. And what they're doing is looking

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for unique opportunities in particular markets and in particular locations within those markets with the right brands, where they still believe even with higher construction costs, higher labor costs, et cetera, that they can drive – they can both finance and then drive ultimately returns on their equity that makes sense. And so what we are seeing. I mean, a testament to that is the number I gave you that we expect starts in the U.S. to go up 20% this year. What we're seeing is, for the right projects in the right markets in the right locations, with good developers, they are getting things done. And we are – talking about our brands, we are disproportionately a beneficiary of that because our individual brands, either are category killers in terms of market share or they sort of lead – co-lead the pack on average, we have the highest market share in the business. And there is not one brand in the bunch that is not performing at a very high level from a market share point of view. And so that is the basic desire of developers to continue to grow their businesses in a selective way combined with our having the best highest-performing brands in the business, which is just I think objectively and factually true is allowing us to continue to take a disproportionate share of development opportunity out there.

If you look at the inputs, and it is a bit surprising, frankly, I would say based on my expectations coming into the year, which are always – we're always pushing our teams. That's our job. We are outperforming a bit even my expectations. I think when we finish the year, we think in terms of new deal signings I mentioned in my comments over 115,000 rooms, we think we will probably do a bit better than that. It will be the highest level of approvals, deal signings that we'll have had in our history. That's about up close to 10% year-over-year. So while, yes, the macro environment is more challenging, we are performing really well in that regard.

Construction starts which obviously is the next step. If you want to deliver you got to build them. You know, we think when the year's out we'll be up circa 5%. 20% in the U.S., but overall throughout the world 5-plus percent. So, those I think are all very good leading indicators. Frankly, as I said in my prepared comments of what the next few years will bring, you heard that we are cautious as I think everybody is about the same-store growth environment because macro conditions have weakened. There's just no debating that and that's why we're, sort of, giving I would say reasonably cautious guidance on a same-store basis.

But the beautiful thing about this model which is really being driven by what we're talking about pipeline, rooms under construction, and ultimately net unit growth is that even in this environment, we will be able to deliver great bottom-line results. You know, even in a modest, almost flattish RevPAR environment in the third quarter you saw we drove EBITDA growth of 9% – with sort of one-ish for the year.

We're going to grow for the full year EBITDA at 9%, EPS at 13% – 13-plus percent, while we didn't give guidance for next year – with what's being signed, what's going under construction and what we think we will deliver in the 6% to 7% range, we will deliver even in the face of reasonably weak macro conditions, we will deliver another great year, which I think – is again a testament to in a post-spin world – the strength of the business model. And if we do our jobs, we will keep those inputs that we're talking about, signing more deals and rooms under construction, moving in the right direction.

Harry C. Curtis

Analyst, Nomura Instinet LLC

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If I can ask just a quick follow-up that's related. Are you seeing any change in the requirement by lenders for more equity?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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I would say we study that pretty scientifically. I would say after a – what has been a tightening trend meaning less money – a little bit tougher terms all around in the lending environment, we have seen that flatten out. So I would

say quarter-over-quarter over the last couple quarters, I mean, it got harder over the last year or – a year or two. But at this point it is relatively stable.

Harry C. Curtis

Analyst, Nomura Instinet LLC

Okay. Very good. Thank you very much.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

And construction costs by the way this year do after growing at high-single-digit, low-double-digit rates. Our best sense in what we're seeing is that that has been tempered as well, that construction costs are going to be growing in the low to – they're still growing, but in the low to mid-single digits versus high single-digit low-double-digit, which is helpful to a degree.

Harry C. Curtis

Analyst, Nomura Instinet LLC

Very good. Thank you.

Operator: Our next question will come from Carlo Santarelli with Deutsche Bank. Please go ahead.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

Hey, guys. Good morning. Guys, as we think about kind of the unit growth and the RevPAR growth for next year, clearly the under construction pipeline is roughly where it was last year, a little bit above where it was last year at this time. So that should bode well for kind of next year's NUG number. Obviously the RevPAR guidance a little bit more tempered. When we think about though the level of performance from some of the other fees and whatnot that go into kind of 2020 relative to what you got this year from things like the credit card, et cetera, do we think 2020 looks like more of a year where it's NUG plus RevPAR kind of gets us to your expectations for fees? Or is there still some slack in there that would allow you to continue to outperform like you have year-to-date thus far?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

I think, it's more – Carlo, I think it's more the former than the latter. I mean we do believe – we had a big ramp-up in growth rate as we had the new deal with AMX sort of come into play. That is now ramping down. I do believe this will grow in the next several years at somewhat above algorithm growth, if you will, but not materially so. So that it really is going to create as you called a sort of incremental slack. I think, the way to think about next year is simple algorithm kind of growth.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

Great. Thank you. And then just one quick follow-up. Obviously, where you are right now from a leverage perspective a little bit below where you've been. Obviously the capital returns are implied to be up a little bit from where you'd previously guided the range to be for this year. How are you thinking about the current leverage? And as you look out to 2020 with respect to the balance sheet and capital returns?

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

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Yeah, Carlo. This is Kevin. I think, we think about all of that in the same way that we've been thinking about it. So I think the way you should think about it is you've heard us say this before but sort of high level, you should think about the entirety of our recurring free cash flow plus whatever proceeds we get from leveraging the business should drive the capital return.

We're still comfortable with our 3 to 3.5 times range and would be targeting the midpoint. I think what you're seeing this quarter is we did finish a tick lower than the midpoint, and that's really related to the recent Odawara sale and that cash still being on the balance sheet, and a little bit of timing. If we achieve the midpoint of our – midpoint or slightly better of our capital return guidance for the year, we'll be right about in the middle of the range. So, nothing new there.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

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Great. Thank you, guys.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

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Sure.

Operator: The next question comes from Joe Greff of JPMorgan. Please go ahead.

Joseph Greff

Analyst, JPMorgan Securities LLC

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Good morning, guys.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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Good morning, Joe.

Joseph Greff

Analyst, JPMorgan Securities LLC

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Can you break out 3Q performance between business transient and leisure transient? I know, you kind of bucketed them together when you were going through Q3 highlights?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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Yeah. They were pretty comparable. They were both flat. I don't have it in my head. But both basically flat. One was plus. I think business transient was up a tick and leisure transient was down a tick. Recognizing part of the leisure transient thing, a small part, it was weaker. I'm not trying to candy-coat that. There was also a leisure transient comp that was more difficult this year over last year. On the business transient, it was anemic. I mean, it was positive, but anemic. And that was just – I'd love to have a more sophisticated answer, but I think it just had to do with broader weakness.

We did see just a little bit of color, like if we – if I – if you look at business transient, you break it down by segments small business, medium and big businesses. We saw more impact in larger businesses, which – I mean, we have a theory on that. I mean, they're sort of more tied in – most of them are public. They're more tied in to what's going on real-time in the marketplace and maybe reacting to the uncertainty that is out there a little bit more rapidly than small or medium-sized businesses. That's the theory. But we – when we parsed it, we did see more impact in large accounts, but it was basically – the way to look at both of them is they sort of round to flat. One's up a little, one's down a little.

Joseph Greff

Analyst, JPMorgan Securities LLC

Q

Great. Thank you. And as a quick follow-up to that, can you just talk about your exposure to top 25 U.S. markets, what percentage of your fees are tied to these markets, what percentage of maybe thinking about it this way your anticipated 2020 openings are in these markets and obviously look at the STR data of late, that's where you've seen a big level of decel. And that's all from me. Thank you.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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Yeah, happy to do that. We have about in the U.S. about 35%, 38% of our existing supplies in the top 25 markets, a little bit less than that in – from a pipeline point of view. And those markets, while our top 25 has been outperforming the STR data, they have been modestly underperforming the non-top 25. So, we would see some impact from that. I think, if you look across the industry, we are – we do not stand out on the heavy side of that, let's just say.

Joseph Greff

Analyst, JPMorgan Securities LLC

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Thank you very much.

Operator: The next question comes from Shaun Kelley, Bank of America Merrill Lynch. Please go ahead.

Shaun C. Kelley

Analyst, Bank of America Merrill Lynch

Q

Hi, good morning, everyone. Thanks for taking my question. Chris, maybe to follow-up on just the broader environment. As people start to kind of think about the 0% to 1% outlook, and just the overall kind of puts and takes about 2020. Can you just help us think about when you're talking to other either large corporations on the customer side or other kind of fellow CEOs, what are some of the things that might differentiate between high and low in your range? And more importantly, like just any green shoots or things you could see that might be a little bit more on the optimistic side as you're kind of thinking about 2020? Just trying to kind of frame up, how much of this is an extrapolation of current trend versus what could be different having this conversation a year from today?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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Yeah. It's a good question and deserves a good answer, I'm not sure if I have one, I mean, but I'll give you one. I mean, kidding aside, I talk to a lot of customers and I'm doing that all the time. And I would say, none of this will surprise you. I mean what I think the sentiment is broadly is probably a sentiment of everybody on this call. Certainly, the sentiment of everybody in this room which is there are a lot of uncertainties in the world and markets don't like uncertainties. Businesses don't like uncertainties when they're trying to make decisions on

hiring more people, investing in plant and equipment, technology, making bigger decisions that drive investment, that drive demand for hotel rooms.

In this kind of environment, I sort of have described that maybe on the last call their caution flags out. I think everybody is reading the papers, watching what's going on with Brexit, watching what's going on with the trade wars, not only in the U.S. and China, but Korea and Japan, looking at broader economic issues, an election year coming up in the U.S., an impeachment process going on.

And when you – I think, when you add all of that up – again I'm being a master of the obvious here. When you add all of that up, it's creating a level of uncertainty that I think has got people rattled.

And I think what is – that's what you're seeing in the results is, the caution flags are out, people are doing fewer things. I think, you'll see it ultimately in hiring numbers. You'll see it certainly in investment numbers. And it is showing up.

And we're a decent sort of lead indicator, on some of the shorter-term transient trends that, they're just – it's still – they're still travelling. They're still doing things, but maybe it's not as robust as it would otherwise be.

So it's sort of – what would lead to things feeling a little bit better to your question of, like, how do you get to the high end, it's settling some of those things down. I mean, you're going to have an election, that will happen, but that's not going to happen until late in the year.

But trade deals getting done, Brexit getting resolved, just one way or another, not -impeachment resolution. I mean any of these things, I think, or a number of them together getting resolved, certainly, in my opinion, and that is all it is, could give you a boost.

It could sort of release a different level of decision-making, and people being willing to invest more, hire more, and thus have to and want to travel more. But I think you need to see some of – some or a number of these things sort of settle down and people to pull the caution flag in a little bit.

Shaun C. Kelley

Analyst, Bank of America Merrill Lynch

Thank you very much.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah.

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Operator: The next question comes from Stephen Grambling with Goldman Sachs. Please go ahead.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Hi. Thanks. Two follow-ups. I guess, first, how should we think about the opportunity and timing to start pushing some of the new brands overseas?

And then second, how are existing owners' financials or leverage levels similar or different to prior cycles?

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Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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Maybe I'd take the second one first. I think, broadly, people's leverage levels are lower. I mean, as compared to going into the Great Recession, I would say, while debt is fairly available – abundantly available, it is not as crazy available as it was then. So my sense, certainly within our system, is people are much more sensibly levered, as we look at the possibility of a slower growth period of time. In terms of distributing our brands around the world, that is something that's always ongoing.

There's a long answer and there's short one. I'll try and give you the short one, which is, we are constantly looking at the market opportunities based on demand patterns around the world. We are constantly looking at whether we should be creating demand and introducing various brand concepts around the world that may not even exist in certain markets, like extended stay in China, as an example.

And so, you should assume, yes, that part of our program is not only continuing to grow the brands that we have, adding incrementally to that brand portfolio over time, but how we distribute those strategically is front and center in our mind and something we spend a lot of time thinking about. And you will continue to see incremental brand introductions in the parts of the world. Tapestry in Europe, for example, you will see. And you will likely see extended stay entering China in the next 12 months and a whole bunch of other examples around the world of us doing that.

And when you look at it, people think about like NUG and the future of growth, we are really in our infancy in our international growth, both in terms of just – while we're big and we've been doing it a long time, if you really look at our footprint in the world, there's gargantuan opportunity.

But also in most regions of the world, even where we're fully distributed or more fully distributed and we've been there a long time, we may have seven to nine brands of our 17 brands. So not only do we have the opportunity to grow those brands, but we have the opportunity to sort of double down and add over time and in a sensible way a number of incremental brands in every region of the world.

So it's a very strategic thoughtful process of how we go about planting these new flags out there to make sure that we always are doing it in a way that we can support it commercially, because we got to drive returns for owners, which is what makes them come back to want us build more hotels for us. But yes, you should assume we will continue to propagate new brands in all regions of the world in a very systematic sort of strategic way.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

Helpful. I'll turn back to the queue. Thanks so much.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah.

Operator: Our next question is from Thomas Allen of Morgan Stanley. Please go ahead. Go ahead, Thomas, perhaps your line is muted on your end. All right. We'll move to our next question, which will be Robin Farley with UBS. Please go ahead.

Robin M. Farley

Analyst, UBS Securities LLC

Q

Great. Thanks. Two questions. One is I wanted to circle back to your comments on transient leisure because I think it's the first time that you've talked about that being soft or not being up. And I know that Q3 had that tougher comp in last year's Q3, but can you give us any insight into sort of how Q4 is looking with two-thirds visibility on the quarter? Just trying to think about how much of it was the tough comp versus actually an underlying trend.

And I know you talked a lot about a bunch of the macro uncertainties out there. I don't know if those comments were more about the business transient issue or do you think that's – are those the same issues for leisure transient? Just trying to think about whether this is a trend or a tough comp? Thanks.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

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I think – if I'm being honest, I think it's somewhat of a tough comp, but more of a trend. I think our expectation is that fourth quarter will be tough as well. Now the comps aren't as much an issue, but just the broader trends are weaker.

If you look at the retail numbers that were coming out before September, they sort of suggested strength, but September retail numbers were quite weak and I think reflective of what we're seeing in some of the leisure trends.

Again, I think to the extent we get some of the uncertainties out of the air. I think you have plenty of opportunity for consumer confidence, which is still reasonably – not as high as it's been, still reasonably high to drive some reasonable growth in leisure transient. But our expectation – our sort of running assumption right now is under current conditions both leisure and business transient will be weaker. We think they'll be positive generally, but they will be reasonably weak.

Robin M. Farley

Analyst, UBS Securities LLC

Q

Great. That's helpful. Thanks. And then if I could just follow-up with a question about licensing fees which I think Kevin had highlighted with, why you were still able to make your guided range for fee growth even though RevPAR was a little bit below the range. How should we think about that going forward licensing fees? It seems like that can be one-offs or not necessarily as predictable. I guess I don't know if there's any color you can give us to just how to think about licensing fees going forward.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah. Sure, Robin. I'm happy to try. I think – I mean, overall, I think the message is very similar to before. It actually – it's actually – we are lapping over much stronger comps last year as the program was ramping up. And so that's clearly a trend that's going to continue.

License fees actually didn't – were in line with our expectations this quarter and were not one of the reasons why we made our fee growth this quarter. We did have some other non-RevPAR driven fees that did a little bit better, but license fees was not an outsized sort of impact on the quarter. And so – and that'll continue into the fourth quarter which is why you're seeing some of the fee growth guidance for the fourth quarter be a little bit lower because we're lapping over I think 14% fee growth in the fourth quarter of last year.

So overall the program is doing fine by the way – you know, acquisitions – I'll sort of more focus on the full year because it can be lumpy quarter-over-quarter, but we think card acquisition is going to be up about 25% for the year, spend in the mid-to-high teens for the year. So the program is going just fine and you're just seeing that we're lapping over really tough comps from last year.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

A

Yeah. And I would say – the only thing I'd add to that is, it actually is quite stable. I mean, the only thing that's going on is, you're sort of lapping these big ramp-up years of a new program. So the growth rate is coming down just because of the arithmetic. But the programs as it stabilizes is actually quite stable in terms of our expectations of contribution to growth in the next bunch of years.

Robin M. Farley

Analyst, UBS Securities LLC

Q

Okay. Great. Thank you very much.

Operator: The next question comes from Bill Crow of Raymond James. Please go ahead.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Q

Good morning. Hey, Chris. You brought up the election and the political uncertainty. And I think, it's not beyond the realm of possibility that next year we could be dealing with a higher tax environment and potentially a backlash against share repurchases. I'm just trying to think about how your capital allocation decisions may change in that sort of environment, whether you might be more open to external growth in a low-interest rate – lower share repurchase environment?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Interesting and good question, Bill. It's hard to know what's going to happen next year. Having said that, we feel strongly about our capital allocation strategy and buybacks have been around for time and eternity. And while, I know there's been things written about it in the political – with all the political swirl, I personally would bet a whole lot of money against them creating legislation that would restrict buybacks.

I don't believe it makes any sense. Everything I've read about the arguments for it, make no sense. And so I'm not – I don't really have an answer. If that were to change obviously we'd have to think about it, I don't think it. I ultimately don't think it will. And I think our strategy on how we want to return free cash flow that we don't need to grow the business to shareholders in the form of a modest dividend but a lot of buybacks over time is the right strategy. We're going to stick with it. If the law prohibits it, obviously we wouldn't.

But again, I would doubt that that would happen. And I think over the next 5, 10, 15, 20 years if you run the models the result – the best result we can deliver is going to be as a result of that capital allocation strategy.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Q

Great. I'll leave it there. Thank you.

Operator: Next question is from Smedes Rose with Citi. Please go ahead.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Thanks. And I just wanted to follow-up on the capital return question. In the past you sort of indicated that you think you could continue to repurchase and pay dividends along this – in the sort of same range of what you've done this year. Anything about today's guidance or your RevPAR outlook changed that for you at this point?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

No, it doesn't. I mean, Kevin said it, but I'll say it again, because it bears repeating. He did a perfectly fine job doing it. But I know, this is front and center on everybody's mind. I mean, the way you think about our – in an oversimplified way, how we think about our capital allocation program is that every year we're going to produce a certain amount of free cash flow, okay? And we've got to do something with it.

We also have the opportunity to lever and we can lever within the ranges that we've talked about. We could lever beyond that, okay? So, the way I would think about it is in sort of three increments. The first is what are we going to do with our free cash flow? But we've said, and I will say again is we're going to pay a modest dividend, we don't have any intention to increase it from its current level and use all the rest of it to do buybacks. We've also been pretty consistent in saying, and I would say again that within the leverage levels of 3 to 3.5, so assume midpoint 3.25 on a regular basis we will be re-levering because the business can handle that leverage easily. We want to be in the market. We want to be returning capital. We think sort of in that range makes sense.

If the business could, in circumstances, certainly handle more leverage, and we would consider more leverage than the 3 to 3.5, but that would be really as part of market dislocation. And that market dislocation is, nobody likes hearing it, but we'll know when we see it. It would be looking at valuation metrics that are sort of below long-term averages, would be sort of a leading indicator that there may be an opportunity. And so at the moment, okay, we have and will continue to implement both stage one and stage two, all our free cash flow and a re-levering to sort of a roughly midpoint of our target leverage levels. Stage three, we are more than willing to consider at the right moment. We just don't view that moment as now.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. I just want to ask you too, if you – you mentioned China was down 5.6% in the quarter. Is there any way you can break out how much of that was just kind of Hong Kong-driven with what's going on in that market versus overall kind of weakness in leisure that you've talked about on prior calls?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yes, I can. Hong Kong obviously had a tough quarter. Hong Kong was down 40% for us. And that means if you did the math, Mainland China was down a little less than 3%. If you look at the full year, what we think we will deliver in Hong Kong is obviously still sort of in play. We think Greater China will be down as Kevin, I think said, sort of low single digits, so call it 3%. Mainland China, we think, will be flat to down a point, something like that and Hong Kong down 23%, 25%, something like that.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you very much.

Operator: The next question comes from Anthony Powell with Barclays. Please go ahead.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. You talked a lot about transient in the third quarter. How did group bookings before the period look in the quarter? And how does the pace for next year impact your guidance?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Group pace has been fine, I would say, not robust. And week-by-week and month-by-month, it's definitely been choppy. Some of that has to do with the commission change. We're lapping over periods where we went from a 10% to a 7% commission. And so, it created some obtuse behavior last year, which creates comparability issues for this year. But I would say pace has been generally okay, not great. As we look at position for next year, I would say we feel reasonably good about it, not as good as we would have felt at this time last year. So, if you look at system-wide numbers, we're up in kind of the low single-digits. If you compare that to last year at this time, by comparison we were up in the mid single-digits. So, we're up like 2%. Last year, we were up like 5%.

Now, we've given guidance for the year of 0 to 1%, being up 2% in group position going into the year makes us feel good, meaning we had a much higher level of expectation this time last year based in part upon that group position of what we would deliver in RevPAR. Obviously, we have a different view for next year. And we think the group position is up and is supportive of the overall RevPAR guidance that we've given for the year.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Q

Thanks. And maybe just one more. We saw a Waldorf project in San Francisco delayed due to the owner's liquidity challenges. How much of your pipeline is in the luxury segment, and can some of those projects be at risk if the slowdown in the overall environment continues?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah, it's a de minimis amount. It's 1% – 1% and change. So, we've known about San Francisco. I know it got – it became public this week, but we've known about that for the better part of a year. But it's a relatively or a very small part of our overall pipeline. And the projects that are most important to us in that pipeline, not that San Francis is not, but San Francisco has had challenges for a long time. Projects that are really important in that pipeline are – many of them are under construction and we have every expectation they'll be delivered.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: The next question is from Patrick Scholes with SunTrust. Please go ahead.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Hi. Good morning, Chris and Kevin.

Q

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

Good morning.

A

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Morning.

A

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Good morning. You've given some color on group expectations as well as softness in the business traveler. Wondering what you're seeing right now as far as trends in specifically leisure travel and what are your – what are you thinking about next year for leisure. Thank you.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Happy to, but I think we already covered it. I mean, leisure trends in the third quarter, just to recap, were flat to slightly down. Part of that was lapping over tougher comps for leisure transient in 2018. Part of that was just weaker transient business, like the retail numbers were down, starting in September. We're seeing some of that.

A

Our expectation is that we'll have more of the same going into the fourth quarter and built into our assumptions for flat to plus 1% is an expectation of positive, but reasonably anemic transient growth in both the business and the leisure side.

I was asked the question earlier what could change that? Obviously, any one of the things that are going on in the world that is rattling the markets and rattling business in terms of uncertainty, any or all of those or any number of those getting resolved could be helpful, but hope is not a strategy. So, what we've tried to do, both for the fourth quarter and next year, is give you a sense of what we think sort of based on current conditions, which have been weaker.

And again, I said in my earlier comments, we still expect to have not only deliver 9% EBITDA growth and 13% EPS growth this year, and while we're not going to give guidance, given that unit growth, fee growth, et cetera, we expect to have another very good year next year even in the face of what we think will be quite anemic same-store growth.

Patrick Scholes

Analyst, SunTrust Robinson Humphrey, Inc.

Okay. Thank you.

Q

Operator: Our next question will be from David Katz of Jefferies. Please go ahead.

David Katz

Analyst, Jefferies LLC

Q

Hi. Good morning, everyone. I wanted to just ask something because it's come up a number of times over the past few months, and it may sound as though I'm headed in a negative direction, but that's not the case. So, I think the rest of your business model is so crystal clear. With that little preamble, I wanted to ask about the owned and leased portion of the P&L, because what we try and do sometimes is figure out where the leverage to the upside and the downside is within that line item. Can you just talk about the expense base or how – help us think about how the leverage within that owned up and down actually works?

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

A

Yeah. David, I'd say, it generally works the way you're used to it working, because you've been covering real estate companies for a really long time, right? So, these are hotels that are sort of – behave like owned hotels. At the GOP margin level, it's about 30%. And then, they have rent payments because most of them are leased. And so the margins end up being a little bit lower, which adds a touch of operating leverage. But the reality is that the expense base in those hotels is growing about the way it's growing in the broader real estate world, where half the expense model is labor and labor costs are going up, call it, 3.5%, 4% around the world.

Inflation is going up kind of 1.5%, 2% around the world. And so our expense base is growing. And at these levels of RevPAR, it's hard to increase the profitability of the hotels. That said, the segment's getting smaller over time. It's less than 10% of our overall EBITDA. We are transitioning out of a lot of the smaller, less strategic leases. I think we're going to transition out of four leases this year, plus one owned hotel in Odawara that we're selling. And so, that part of the business is getting a little bit smaller. The rest of the business is growing at a 6% to 7% clip.

And so, over time, what you're going to see is, within a reasonable amount of time, you're going to see that segment be 5% of the business overall, and the revenue expense dynamics are going to work the same. It's just going to affect the overall answer even less.

David Katz

Analyst, Jefferies LLC

Q

Got it. Perfect. Thank you very much.

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

A

Sure.

Operator: The next question is from Jared Shojaian with Wolfe Research. Please go ahead.

Jared Shojaian

Analyst, Wolfe Research LLC

Q

Hi. Good morning, everyone. Thanks for taking my question. The G&A guidance came down a little for the year at the high end. How much flex do you think you have on the G&A side if RevPAR continues to weaken? And any color you can share on how you're thinking about 2020 right now?

Kevin J. Jacobs

Executive Vice President and Chief Financial Officer, Hilton Worldwide Holdings, Inc.

A

Yeah. Jared, we can continue to do better. We try to be as efficient as we can. I mean some of it's coming down. We tightened the range. And it got a bit lower because as we've seen RevPAR coming down, we've just done better. Now, we have a certain amount of expenses in the business, and can we do enough there that it's sort of going to overcome 2% RevPAR going to 1%, if it goes to zero? Not really, but you should expect that we can continue to do better. And we've consistently over a number of years now grown G&A at a rate that's less than inflation overall and I think we can continue to do that.

Jared Shojaiian

Analyst, Wolfe Research LLC

Q

Great. Thank you. And one more quick one, if I may. Chris, I think I heard you say you're feeling good about your ability to deliver over 6% net unit growth over the next several years. What kind of risks are there if the environment softens from here? I guess, what would cause you to be below 6% beyond next year?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah. I mean, the risk is you go into another Great Recession sort of or material recessionary environment, but I feel good about it because the inputs are largely in place. So even if you go into a much slower environment than we're experiencing today, these hotels that are under construction which is over half the pipeline are almost all going to get completed, number one. The only other input is conversions, and what I would argue is, in a weaker environment it actually stimulates more conversion activity, not less.

So for the few hotels that might fall out, that maybe that are under construction and for some reason, don't complete and that is very rare if that happened. I would bet that we would more than compensate for it with incremental conversion. So that's why, I didn't lightly say, I feel good about our ability to continue for the next few years to drive over 6% net unit growth, because I think the inputs are largely in place. So, I mean, there's always downside. Our General Counsel will be staring me down if I didn't say it, but we said we feel good about it because I do feel good about it.

Jared Shojaiian

Analyst, Wolfe Research LLC

Q

Great. Thank you very much.

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Chris Nassetta for any closing remarks.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Thanks everybody for the time today. Obviously, a lot going on in the environment, we'll watch the fourth quarter carefully, continue to do our part to drive bottom line results. Look forward to summarizing the year in February. And for those Nats fans out there, Go Nats, we've won last night. Hopefully, good night tonight, and we'll have our first World Series in Washington in history. Anyway thanks everybody. Have a great day.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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